

Michigan Department of Licensing and Regulatory Affairs
Office of Regulatory Reinvention
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**REGULATORY IMPACT STATEMENT
and
COST-BENEFIT ANALYSIS**

PART 1: INTRODUCTION

In accordance with the Administrative Procedures Act (APA) [1969 PA 306], the department/agency responsible for promulgating the administrative rules must complete and submit this form electronically to the Office of Regulatory Reinvention (ORR) no less than (28) days before the public hearing [MCL 24.245(3)-(4)]. Submissions should be made by the departmental Regulatory Affairs Officer (RAO) to **orr@michigan.gov**. The ORR will review the form and send its response to the RAO (see last page). Upon review by the ORR, the agency shall make copies available to the public at the public hearing [MCL 24.245(4)].

Please place your cursor in each box, and answer the question completely.

ORR-assigned rule set number:

R. 500.101-R 500.111

ORR rule set title:

Captive Insurance Company Rules

Department:

Department of Insurance and Financial Services

Agency or Bureau/Division

Office of Insurance Evaluation

Name and title of person completing this form; telephone number:

Sarah Wohlford, Staff Attorney, 517-373-1624

Reviewed by Department Regulatory Affairs Officer:

Joseph A. Garcia, Deputy General Counsel, 517-373-7466

PART 2: APPLICABLE SECTIONS OF THE APA

MCL 24.207a “Small business” defined.

Sec. 7a.

“Small business” means a business concern incorporated or doing business in this state, including the affiliates of the business concern, which is independently owned and operated and which employs fewer than 250 full-time employees or which has gross annual sales of less than \$6,000,000.00.”

MCL 24.240 Reducing disproportionate economic impact of rule on small business; applicability of section and MCL 24.245(3).

Sec. 40.

(1) When an agency proposes to adopt a rule that will apply to a small business and the rule will have a disproportionate impact on small businesses because of the size of those businesses, the agency shall consider exempting small businesses and, if not exempted, the agency proposing to adopt the rule shall reduce the economic impact of the rule on small businesses by doing all of the following when it is lawful and feasible in meeting the objectives of the act authorizing the promulgation of the rule:

(a) Identify and estimate the number of small businesses affected by the proposed rule and its probable effect on small businesses.

(b) Establish differing compliance or reporting requirements or timetables for small businesses under the rule after projecting the required reporting, record-keeping, and other administrative costs.

(c) Consolidate, simplify, or eliminate the compliance and reporting requirements for small businesses under the rule and identify the skills necessary to comply with the reporting requirements.

(d) Establish performance standards to replace design or operational standards required in the proposed rule.

(2) The factors described in subsection (1)(a) to (d) shall be specifically addressed in the small business impact statement required under section 45.

(3) In reducing the disproportionate economic impact on small business of a rule as provided in subsection (1), an agency shall use the following classifications of small business:

(a) 0-9 full-time employees.

(b) 10-49 full-time employees.

(c) 50-249 full-time employees.

(4) For purposes of subsection (3), an agency may include a small business with a greater number of full-time employees in a classification that applies to a business with fewer full-time employees.

(5) This section and section 45(3) do not apply to a rule that is required by federal law and that an agency promulgates without imposing standards more stringent than those required by the federal law.

MCL 24.245 (3) “Except for a rule promulgated under sections 33, 44, and 48, the agency shall prepare and include with the notice of transmittal a **regulatory impact statement** containing...” (information requested on the following pages).

[**Note:** Additional questions have been added to these statutorily-required questions to satisfy the **cost-benefit analysis** requirements of Executive Order 2011-5.]

MCL 24.245b Information to be posted on office of regulatory reinvention website.

Sec. 45b. (1) The office of regulatory reinvention shall post the following on its website within 2 business days after transmittal pursuant to section 45:

- (a) The regulatory impact statement required under section 45(3).
- (b) Instructions on any existing administrative remedies or appeals available to the public.
- (c) Instructions regarding the method of complying with the rules, if available.
- (d) Any rules filed with the secretary of state and the effective date of those rules.

(2) The office of regulatory reinvention shall facilitate linking the information posted under subsection (1) to the department or agency website.

PART 3: DEPARTMENT/AGENCY RESPONSE

Please place your cursor in each box, and provide the required information, using complete sentences. Please do not answer the question with “N/A” or “none.”

Comparison of Rule(s) to Federal/State/Association Standards:

(1) Compare the proposed rule(s) to parallel federal rules or standards set by a state or national licensing agency or accreditation association, if any exist. Are these rule(s) required by state law or federal mandate? If these rule(s) exceed a federal standard, please identify the federal standard or citation, and describe why it is necessary that the proposed rule(s) exceed the federal standard or law, and specify the costs and benefits arising out of the deviation.

There are no parallel federal rules, state standards, national licensing standards, or accreditation association standards applicable to these proposed rules. These rules are not required by state law or federal mandate; however, DIFS is authorized to promulgate these rules under Sections 210, 4651, 4747, and 4813 of the Insurance Code of 1956 (MCL 500.210, 500.4651, 500.4747, and 500.4813).

(2) Compare the proposed rule(s) to standards in similarly situated states, based on geographic location, topography, natural resources, commonalities, or economic similarities. If the rule(s) exceed standards in those states, please explain why, and specify the costs and benefits arising out of the deviation.

Generally speaking, the proposed rules have three components: 1) a requirement for audited financial statements; 2) record retention guidelines; and 3) authorization of captive managers. Currently, audited financial statements are required of only traditional insurance companies and special purpose financial captive insurance companies licensed under Chapter 47 in Michigan. Most, if not all, states that domicile captives require audited financial statements of captive insurance companies. Because the insurance industry is regulated by states, there are no federal standards that apply. Regarding record retention, traditional insurance companies are currently required to maintain the types of documents listed in these proposed rules. These documents would be used when conducting financial examinations of captive insurance companies. The National Association of Insurance Commissioners (NAIC), which accredits state insurance departments in the United States, publishes guidance on the documents that are needed to be reviewed when conducting a financial review of an insurance company. Regarding the captive manager authorization, most, if not all, states that domicile captives have a similar requirement, because captive managers typically run the day-to-day operations of the captive insurance company. Like the captive statute, these proposed rules are patterned after similar rules in Vermont, Arizona, and South Carolina. Each of those states is a major domicile for captive insurance companies, and is known for its regulatory structure that provides reasonable oversight while providing for robust competition.

(3) Identify any laws, rules, and other legal requirements that may duplicate, overlap, or conflict with the proposed rule(s). Explain how the rule has been coordinated, to the extent practicable, with other federal, state, and local laws applicable to the same activity or subject matter. This section should include a discussion of the efforts undertaken by the agency to avoid or minimize duplication.

We do not know of any duplication, overlap, or conflict of the proposed rules. However, most entities already have an audit conducted as a matter of good business practice and most captive insurance companies will already be retaining most, if not all, of the documents relating to record retention.

Purpose and Objectives of the Rule(s):

(4) Identify the behavior and frequency of behavior that the proposed rule(s) are designed to alter. Estimate the change in the frequency of the targeted behavior expected from the proposed rule(s). Describe the difference between current behavior/practice and desired behavior/practice. What is the desired outcome?

Regarding the requirement for audited financial statements, the benefits include an independent, objective assessment of risk, controls, and compliance. The management, as well as regulators,

shareholders, suppliers, and financiers, are assured that the risks in the organization are well-studied, and effective systems are in place to handle them. Audits can improve a company's efficiency and profitability by helping the management better understand their own internal processes and financial systems. Having an audit also lessens the risk and therefore the cost of capital. Audits can also identify areas in an organization's financial structure that need improvement, and how to implement the proper changes and adjustments. An audit can uncover inaccuracies and discrepancies within an organization's records, which may be indications of weak financial organization or even internal fraud, although fraud detection is not the main purpose of an audit. Audits ensure that financial statement amounts are reliable, consistent, and in compliance with established accounting principles. Audits also provide assurances to regulators that an independent professional has reviewed the financial statements. Currently, captive insurance companies voluntarily have their financial statements audited by an independent party. The proposed rules are necessary to ensure the accessibility of the audited financial statements. Regarding record retention, DIFS is required by law to conduct financial examinations of captive insurance companies licensed in Michigan. The proposed rules list the documents required to be retained as well as the duration of the retention period, which will enable DIFS to conduct financial examinations. Without such a list, DIFS' ability to conduct a timely and efficient exam is compromised. Regarding captive manager authorization, DIFS needs to ensure that the persons who are conducting the day-to-day operations of a licensed captive are qualified to do so.

(5) Identify the harm resulting from the behavior that the proposed rule(s) are designed to alter and the likelihood that the harm will occur in the absence of the rule. What is the rationale for changing the rule(s) and not leaving them as currently written?

Regarding the audited financial statement requirement: in the absence of such a requirement, DIFS has no independent verification that the financial statements are complete, accurate, and prepared according to applicable reporting guidelines. DIFS only conducts onsite financial exams every 5 years or on an as-needed basis. Therefore, it is crucial that the accuracy of the financial statements it receives on an annual basis are accurate. Regarding record retention, if the proposed rule is not enacted, it is possible that DIFS' examinations of captive insurance companies will be less efficient and thus more costly to the captive insurance company. Regarding the captive manager authorization: in the absence of a rule, the day-to-day operation of a captive insurance company could be performed by an individual who is not qualified to do so, or familiar with captive insurance companies.

(6) Describe how the proposed rule(s) protect the health, safety, and welfare of Michigan citizens while promoting a regulatory environment in Michigan that is the least burdensome alternative for those required to comply.

Regarding the audited financial statement requirement, accurate financial statements not only protect that entity itself but also Michigan citizens. Regarding record retention, the proposed list of documents needed for a financial examination will lead to better and more effective examinations, which are designed to protect Michigan citizens. Regarding captive manager authorization, the proposed rule will ensure that those who are conducting the day-to-day operations of a captive insurance company are qualified to do so which protects Michigan citizens.

(7) Describe any rules in the affected rule set that are obsolete, unnecessary, and can be rescinded.

There are no affected rules that are obsolete or unnecessary.

Fiscal Impact on the Agency:

Fiscal impact is an increase or decrease in expenditures from the current level of expenditures, i.e. hiring additional staff, an increase in the cost of a contract, programming costs, changes in reimbursement rates, etc. over and above what is currently expended for that function. It would not include more intangible costs or benefits, such as opportunity costs, the value of time saved or lost, etc., unless those issues result in a measurable impact on expenditures.

(8) Please provide the fiscal impact on the agency (an estimate of the cost of rule imposition or potential savings on the agency promulgating the rule).

There is no fiscal impact on the department. Audited financial statements are received on an annual basis and, with the rules' record retention provisions, DIFS' examinations will be more expedient and less costly for DIFS and for the captive insurers, because the rules will result in the required information being more readily available and accurate.

(9) Describe whether or not an agency appropriation has been made or a funding source provided for any expenditures associated with the proposed rule(s).

There are no projected expenditures associated with the proposed rule.

(10) Describe how the proposed rule(s) is necessary and suitable to accomplish its purpose, in relationship to the burden(s) it places on individuals. Burdens may include fiscal or administrative burdens, or duplicative acts. So despite the identified burden(s), identify how the requirements in the rule(s) are still needed and reasonable compared to the burdens.

The proposed rule was deemed necessary to remedy omissions in the initial captive legislation. Most, if not all, states that allow for captive insurance companies have the components of the proposed rule within their statutes or rules. The proposed rules are necessary because other states that have captive insurance programs have similar or identical requirements in their statutes or rules. In addition, the proposed rules codify current business practices. The most significant part of the proposed rule requires audited financial statements from captives. These captives already voluntarily file such statements, so the rules will impose no additional burden but will codify existing practice.

Impact on Other State or Local Governmental Units:

(11) Estimate any increase or decrease in revenues to other state or local governmental units (i.e. cities, counties, school districts) as a result of the rule. Estimate the cost increases or reductions on other state or local governmental units (i.e. cities, counties, school districts) as a result of the rule. Please include the cost of equipment, supplies, labor, and increased administrative costs, in both the initial imposition of the rule and any ongoing monitoring.

There are no increases or decreases in revenues or costs to other state or other local government units as a result of the rule.

(12) Discuss any program, service, duty or responsibility imposed upon any city, county, town, village, or school district by the rule(s). Describe any actions that governmental units must take to be in compliance with the rule(s). This section should include items such as record keeping and reporting requirements or changing operational practices.

The proposed rule will not affect any city, county, town or school district.

(13) Describe whether or not an appropriation to state or local governmental units has been made or a funding source provided for any additional expenditures associated with the proposed rule(s).

There are no additional expenditures associated with the proposed rule for state or local government units.

Rural Impact:

(14) In general, what impact will the rules have on rural areas? Describe the types of public or private interests in rural areas that will be affected by the rule(s).

Rural areas will not be affected by the rule.

Environmental Impact:

(15) Do the proposed rule(s) have any impact on the environment? If yes, please explain.

No, the proposed rule will not have any impact on the environment.

Small Business Impact Statement:

[Please refer to the discussion of “small business” on page 2 of this form.]

(16) Describe whether and how the agency considered exempting small businesses from the proposed rules.

Entities that own captive insurance companies rarely, if ever, meet the definition of a “small business.” However, under the rule, DIFS would have the ability to exempt any company from filing audited financial statements on a case-by-case basis. The other components of the proposed rule, (captive manager and record retention) have no material costs associated with them. Accordingly, DIFS considered exempting small businesses from the proposed rules but determined that it was unnecessary to do so because the exemption would rarely, if ever, apply.

(17) If small businesses are not exempt, describe (a) the manner in which the agency reduced the economic impact of the proposed rule(s) on small businesses, including a detailed recitation of the efforts of the agency to comply with the mandate to reduce the disproportionate impact of the rule(s) upon small businesses as described below (in accordance with MCL 24.240(1)(A-D)), or (b) the reasons such a reduction was not lawful or feasible.

Traditionally, captive insurance companies are not formed by small businesses. However, if a small business that formed a captive insurance company under Chapter 46 of the Michigan Insurance Code was able to show financial hardship by the requirement of an audit, DIFS would consider exemption from the requirement on a case-by-case basis.

(A) Identify and estimate the number of small businesses affected by the proposed rule(s) and the probable effect on small business.

We estimate the number of small businesses affected by the proposed rule to be zero because any small businesses that own currently-licensed captives already voluntarily comply with the requirements set forth in the rule.

(B) Describe how the agency established differing compliance or reporting requirements or timetables for small businesses under the rule after projecting the required reporting, record-keeping, and other administrative costs.

DIFS would have the ability to exempt a captive insurance company from having audited financial statements on a case-by-case basis. As a matter of good business practice, most captive insurance companies, if not all, are already voluntarily having their financial statements audited by an independent party.

(C) Describe how the agency consolidated or simplified the compliance and reporting requirements and identify the skills necessary to comply with the reporting requirements.

As a matter of good business practice, most captive insurance companies, if not all, are already voluntarily having their financial statements audited by an independent party. Captive insurance companies are required to submit a financial report on a GAAP or statutory basis, which are the same standards used in a financial statement audit.

(D) Describe how the agency established performance standards to replace design or operation standards required by the proposed rules.

Captive insurance companies are required to submit a financial report on a GAAP or statutory basis, which are the same standards used in a financial statement audit.

(18) Identify any disproportionate impact the proposed rule(s) may have on small businesses because of their size or geographic location.

We estimate the proposed rule will have no disproportionate impact on small businesses because of their size or geographic location.

(19) Identify the nature of any report and the estimated cost of its preparation by small business required to comply with the proposed rule(s).

Small businesses rarely own captive insurance companies. There are currently 14 captive insurance companies domiciled in Michigan. The cost of audited financial statements for a captive insurance company range from \$12,000 to \$24,000, based upon a poll of the three captive insurance companies domiciled in Michigan which most recently submitted audited financial statements.

(20) Analyze the costs of compliance for all small businesses affected by the proposed rule(s), including costs of equipment, supplies, labor, and increased administrative costs.

Small businesses rarely own captive insurance companies. The only costs with the proposed rule would be for audited financial statements, a requirement from which DIFS would have the authority to exempt certain companies. See number 18.

(21) Identify the nature and estimated cost of any legal, consulting, or accounting services that small businesses would incur in complying with the proposed rule(s).

Small businesses rarely own captive insurance companies. The only costs with the proposed rule would be for audited financial statements. See number 18.

(22) Estimate the ability of small businesses to absorb the costs without suffering economic harm and without adversely affecting competition in the marketplace.

Small businesses rarely own captive insurance companies. The range of costs for audited financial statements is \$12,000 to \$24,000. We believe that cost would not cause economic harm or adverse competition, as many small businesses already engage auditors for financial statements.

(23) Estimate the cost, if any, to the agency of administering or enforcing a rule that exempts or sets lesser standards for compliance by small businesses.

We estimate no cost to the department.

(24) Identify the impact on the public interest of exempting or setting lesser standards of compliance for small businesses.

We estimate no impact on the public interest of exempting small business.

(25) Describe whether and how the agency has involved small businesses in the development of the proposed rule(s). If small business was involved in the development of the rule(s), please identify the business(es).

Small businesses rarely own captive insurance companies, and it is impossible to identify which small businesses might form a captive insurance company in the future. Thus, the department has not involved small businesses in the development of the proposed rule.

Cost-Benefit Analysis of Rules (independent of statutory impact):

(26) Estimate the actual statewide compliance costs of the rule amendments on businesses or groups. Identify the businesses or groups who will be directly affected by, bear the cost of, or directly benefit from the proposed rule(s). What additional costs will be imposed on businesses and other groups as a result of these proposed rules (i.e. new equipment, supplies, labor, accounting, or recordkeeping)? Please identify the types and number of businesses and groups. Be sure to quantify how each entity will be affected.

The only costs associated with the proposed rule are related to audited financial statements. Most captive insurance companies are already incurring costs for audited financial statements. Typical costs for audited financial statements for captive insurance companies are in the range of \$12,000 to \$24,000. The only entities affected by the proposed rules related to audited financial statements would be captive insurance companies licensed under Chapter 46 of the Michigan Insurance Code. As of this date there

are 14 captive insurance companies who have been granted a limited certificate of authority in Michigan. It is anticipated we will receive audited financial statements from all 13 captive insurance companies licensed under Chapter 46 of the Michigan Insurance Code. The one captive insurance company licensed under Chapter 47, which requires audited financial statements, has an exemption from filing since it is inactive.

(27) Estimate the actual statewide compliance costs of the proposed rule(s) on individuals (regulated individuals or the public). Please include the costs of education, training, application fees, examination fees, license fees, new equipment, supplies, labor, accounting, or recordkeeping). How many and what category of individuals will be affected by the rules? What qualitative and quantitative impact does the proposed change in rule(s) have on these individuals?

The only costs associated with the proposed rule are related to audited financial statements. As a matter of good business practice, captive insurance companies in Michigan currently undergo a financial statement audit and it is anticipated that all captive insurance companies licensed under Chapter 46 of the Michigan Insurance Code will voluntarily submit audited financial statements, if they do not do so already. As such, there is no additional cost.

(28) Quantify any cost reductions to businesses, individuals, groups of individuals, or governmental units as a result of the proposed rule(s).

We estimate no cost reductions to businesses as a result of the proposed rule.

(29) Estimate the primary and direct benefits and any secondary or indirect benefits of the proposed rule(s). Please provide both quantitative and qualitative information, as well as your assumptions.

The benefits of an audit include an independent, objective assessment of risk, controls, and compliance. The management, as well as regulators, shareholders, suppliers and financiers, are assured that the risks in the organization are well-studied, and effective systems are in place to handle them. Audits can improve a company's efficiency and profitability by helping the management better understand their own internal processes and financial systems. An independent audit also lessens the risk and therefore the cost of capital. Audits can also identify areas in an organization's financial structure that need improvement, and how to implement the proper changes and adjustments. An audit can uncover inaccuracies and discrepancies within an organization's records, which may be indications of weak financial organization or even internal fraud, although fraud detection is not the main purpose of an audit. Due to audits, financial statement amounts are more reliable, consistent, and based upon established accounting principles. As a regulatory body we can gain comfort that another independent professional has reviewed the financial statements. Currently, captive insurance companies voluntarily have their financial statements audited by an independent party. The benefits of requiring the captive manager authorization include ensuring managers meet minimum qualifications and the day-to-day operations of captive insurance companies are managed by individuals with the appropriate knowledge, background, and experience. Regarding record retention, DIFS is required by law to conduct financial examinations of captive insurance companies licensed in Michigan. The proposed rules list those documents and the duration of time those documents must be kept, which will enable DIFS to conduct financial examinations. Without such a list, DIFS' ability to conduct a timely and efficient exam will be compromised.

(30) Explain how the proposed rule(s) will impact business growth and job creation (or elimination) in Michigan.

The proposed rule will have little to no impact on job creation or job elimination in Michigan. The proposed rule has marginal potential to have a positive impact on business growth in Michigan by demonstrating that Michigan is committed to its captive insurance program.

(31) Identify any individuals or businesses who will be disproportionately affected by the rules as a result of their industrial sector, segment of the public, business size, or geographic location.

The proposed rules will only affect captive insurance companies.

(32) Identify the sources the agency relied upon in compiling the regulatory impact statement, including the methodology utilized in determining the existence and extent of the impact of a proposed rule(s) and a cost-benefit analysis of the proposed rule(s). How were estimates made, and what were your assumptions? Include internal and external sources, published reports, information provided by associations or organizations, etc., which demonstrate a need for the proposed rule(s).

The only cost associated with the proposed rule relate to the audited financial statements. DIFS polled three captive insurance companies that voluntarily submitted audited financial statements and determined a range between \$12,000 and \$24,000.

Alternatives to Regulation:

(33) Identify any reasonable alternatives to the proposed rule(s) that would achieve the same or similar goals. In enumerating your alternatives, please include any statutory amendments that may be necessary to achieve such alternatives.

We know of no reasonable alternatives to the proposed rule that would achieve the same or similar goals. The only way to examine the financial condition of a captive insurance company is to have an independent professional perform a comprehensive review of the financial statements. The best way to gain reasonable assurance regarding the financial health of a captive insurance company is to have a qualified independent certified public accountant conduct an audit. Audits conducted by an independent third party on a compulsory basis will provide measurable, consistent, reliable, and reasonable results in relation to financial standing.

(34) Discuss the feasibility of establishing a regulatory program similar to that proposed in the rule(s) that would operate through private market-based mechanisms. Please include a discussion of private market-based systems utilized by other states.

The only cost associated with the proposed rules are related to the audited financial statements. Audited financial statements are executed by independent certified public accountants who are in the private marketplace and qualified by the AICPA, the national rule-making and standard-setting organization for certified public accountants. To our knowledge, there are no private market-based systems utilized by other states.

(35) Discuss all significant alternatives the agency considered during rule development and why they were not incorporated into the rule(s). This section should include ideas considered both during internal discussions and discussions with stakeholders, affected parties, or advisory groups.

The proposed rule was deemed necessary to remedy omissions in the initial captive legislation. Most, if not all, states that allow for captive insurance companies have the components of the proposed rule within their statutes or rules. The rule will help ensure that Michigan's captive program remains competitive with other states' captive programs.

Additional Information

(36) As required by MCL 24.245b(1)(c), please describe any instructions regarding the method of complying with the rules, if applicable.

Not applicable.

PART 4: REVIEW BY THE ORR

Date Regulatory Impact Statement (RIS) received:

11-7-2014

Date RIS approved:

11-13-2014

ORR assigned rule set

2014-152 IF

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| Date of disapproval: | Explain: |
| More information needed: | Explain: |

(ORR-RIS March 2014)